

California conforms to federal pension laws

In May, with the enactment of Assembly Bill 1122 (Stats. 2002, Ch. 35) and Senate Bill 657 (Stats. 2002, Ch. 34), the California Legislature passed an omnibus federal conformity package that includes conformity to the new federal pension laws, retroactive to January 1, 2002.

Specifically, these bills conformed to: pension plan, Coverdell Education Savings Account, and qualified tuition plan changes contained in the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The bills:

- Increase individual retirement arrangements contributions to \$3,000 in 2002 and to \$5,000 by 2008.
- Increase Section 401(k) and 457 contributions to \$11,000 in 2002 and to \$15,000 over five years. Both 401(k) and 457 plans can be funded and the bills make both plans equal in other aspects. (e.g., rollovers).
- Allow individuals age 50 and over to contribute an extra \$500 to an IRA or a Roth IRA in 2002, and an additional \$1,000 beginning in 2006.
- Increase Coverdell account contributions to \$2,000 in 2002.
- Exclude scholarship-type savings plan distributions used for education expenses from income tax.
- Permit private organizations to maintain a qualified tuition program.

Contributions of publicly traded stock to private foundations

This provision only applies to personal income tax law. Contributions of

publicly traded stock (e.g., listed on the New York Stock Exchange) to private foundations may now be deducted at the stock's fair market value.

Existing state law only allows the basis of stock or other property contributions to private foundations to be deducted.

Gifts of appreciated property for alternative minimum tax purposes

Gifts of capital assets to most charities (e.g., churches, food banks and etc.) are deductible at the asset's fair market value. This provision provides that the gain portion of a contribution of a capital asset is not an AMT item.

Federal S corporation election requiring corporations with a valid S election for federal law to be an S corporation for California law

Previous state law permitted a taxpayer that made a valid election to be treated as an S corporation for federal tax purposes to elect to be treated as a C corporation for California tax purposes.

This provision requires all taxpayers with a valid federal S corporation election to be an S corporation for state purposes. The provision is effective for taxable years beginning on or after January 1, 2002, and provides for transitional relief for C corporations that made estimated tax payments for their 2002 taxable year.

Discharge of Indebtedness of an S corporation

Cancellation of debt (COD) income is not includible in income if the taxpayer

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Tax News

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TAX NEWS is a bimonthly publication of the Communications Services Bureau, California Franchise Tax Board. Its primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

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Budget Conference Committee rejects mandatory e-file proposal

California will likely not have mandatory e-file in 2003. The Legislature's Budget Conference Committee rejected Governor Davis' proposal to include mandatory e-file in the 2002-2003 budget.

The Governor's proposal was designed to reduce the state's cost of processing tax returns. It could have shifted 3.25 million returns from paper to e-file, saving

the state over two million tax dollars in its first year of implementation. Tax preparers who prepared more than 100 California individual income tax returns for tax year 2001 would have been required to file all subsequently prepared individual income tax returns electronically. It also imposed a \$50 per return penalty on those tax practitioners or businesses that did not comply.

FTB mails head of household questionnaires

The 2001 head of household audit season begins in July with the first mailing of audit questionnaires. These important facts about our Head of Household Program can help you better serve your affected clients.

E-filers get a leg up

In general, taxpayers who completed *Head of Household Questionnaire*, form FTB 1540e, at the time they e-filed their tax return will not receive a head of household questionnaire. There are a few exceptions.

The questionnaire instructions are easier to follow.

The 2001 Head of Household audit letter now provides a specific date by which taxpayers are to mail or fax us their completed questionnaire.

Need help? We're on the Internet.

Our Head of Household Webpage, www.ftb.ca.gov/hoh/index.html, provides information on the rules for qualifying for the head of household filing status, our

audit process, and answers to frequently asked questions. There's also a self-test to help taxpayers determine if they qualify for the filing status.

To get to the Webpage, go to our Franchise Tax Board Website at www.ftb.ca.gov, select *Tax Assistance* on the topic index on the right side of the page, and select *Head of Household*.

Need more help?

Schedule a workshop. Our Head of Household Program conducts workshops on the head of household filing requirements for interested tax practitioners. Workshops include a head of household program overview, an explanation of the qualification criteria, and a discussion about important questions you should ask your clients who file using the head of household filing status.

To schedule a head of household workshop in your area, contact our Head of Household Program at (916) 845-6419 or send us an email at HOH@ftb.ca.gov.

Payment by credit card options expanded

Taxpayers now have four options to choose from if they want to make tax payments by credit card. In addition to Discover/NOVUS, MasterCard, and American Express, we now accept VISA.

To pay by credit card, go to the *Official Payments Corp.* Website at www.officialpayments.com, or call them toll-free at (800) 272-9829.

State conforms to federal pension laws

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is in bankruptcy or to the extent the taxpayer is insolvent.

The taxpayer's tax attributes (e.g., basis in assets) must be reduced by the amount of COD income. An S corporation with COD income must reduce its tax attributes by the COD income amount.

The U.S. Supreme Court decided in January of 2001, that shareholders could increase their basis in the S corporation by the COD income. Congress passed a provision in January of 2002 to reverse the U.S. Supreme Court's decision and not permit shareholders to increase their basis in the S corporation's stock. This provision conforms state law to the new January 2002 federal provision.

Deduction of club dues

This provision eliminates the deduction of club dues as a business expense. Business expenses that are otherwise deductible although incurred at a club (e.g., meals) continue to be deductible.

Deduction of excess compensation for officers

This provision eliminates deduction of compensation of certain officers of publicly traded corporations in excess of \$1 million per year. This rule does not apply to certain compensation that is based on the individual's personal performance.

Disallowance of lobbying and political expenses

This provision eliminates the business expense deduction of lobbying or political expenses incurred to influence Congress, a state legislature or constitutional officers, and certain federal executive branch officials.

Estimated tax payments of individuals

This provision increases the required

estimated tax payments from 80 percent to 90 percent of the current year tax, and requires alternative minimum tax to be included in the computation of the estimate tax payments.

It also provides that no penalties will be assessed for underpayment of estimated taxes owed prior to April 15, 2003, if the underpayment is due to changes contained in the bill.

Numerous federal changes made between January 1, 1998, and January 1, 2001

This provision conforms to 28 federal changes, including the augmented deduction for corporate computer donations.

For more details on these bills, go to the analyses section of our Law and Legislation Webpage located on our Website, www.ftb.ca.gov.

You also can find comprehensive information about all legislative measures on the Internet at www.leginfo.ca.gov, the Official California Legislation Information website.

Editor's note:

On June 22, 2002, the Howard Jarvis Taxpayers' Association and the 44 Republicans in the Legislature filed a lawsuit challenging several provisions contained in Assembly Bill 1122 (Stats. 2002-35).

Governor Gray Davis and the Franchise Tax Board were named defendants in the lawsuit.

Keep checking our Website, www.ftb.ca.gov, especially Tax News Online, for information on the lawsuit and how it might affect California's conformity to federal pension laws and other federal laws referenced in AB 1122.

Ask the Advocate



Debbie Newcomb
Taxpayer
Advocate

Dear Readers: Instead of an answer to a question, today I'd like to invite you to this year's California Tax Policy Conference.

The conference will be held November 13-15 at the Sheraton Grand Hotel in Sacramento, California.

Our annual three-day conference has earned an outstanding reputation in the tax professional community. Tax experts from around the country discuss the hottest issues facing tax professionals from both government and private industry perspectives. It's the most important forum of its kind for discussion of critical tax policy issues.

If your job requires up-to-date knowledge of significant issues in state taxation, you should plan to attend this prestigious conference. It's a must for corporate officers, certified public accountants, government officials, tax attorneys, and other tax specialists.

Don't miss out. This is your chance to impact tax policy issues. Go to our website at www.ftb.ca.gov/education/ctpc/index.html to register now.

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Nonfiler program issues notices to business entities

If you've been putting off preparing past due tax returns for any of your business clients, you might want to consider making them a priority.

If not, those clients can expect to see a notice from us in the next month or so asking for their return.

In July we will send the first batch of approximately 50,000 nonfiler notices to

identified business entities that have failed to file their returns for the year 1999.

There is good news. We recently revised our nonfiler notices to make them more clear, concise, and easier to understand.

We also tailored the notices to each type of nonfiling entity, rather than the old one size fits all approach.

There are also more options for responding to our notices, including a public Website (www.ftb.ca.gov/INC) and an improved Interactive Voice Response phone system.

You can use both of these to request additional time to respond to the notice, research answers to frequently asked questions, and download needed tax forms.

Minimum franchise tax payment requirements vary for foreign corporations doing business in California

Corporations that incorporate or qualify with the California Secretary of State on or after January 1, 2000, are no longer required to make a prepayment to the Secretary of State and are not subject to the minimum franchise tax on their first return. These corporations pay only a measured tax on their first tax return.

Limited liability companies treated as corporations

On or after January 1, 2000, foreign or domestic limited liability companies that elect, for tax purposes, to be treated as corporations, are not subject to the minimum franchise tax on their first return but are subject to measured tax.

Limited liability companies that are treated as corporations do not register with the Secretary of State as a corporation.

Non-qualified foreign corporations

Non-qualified foreign corporations that began doing business in California on or after January 1, 2000,

must pay at least the minimum franchise tax on their first tax return.

Example 1

Foreign *ABC Corporation* (a calendar year corporation) began doing business in California on January 10, 2000. *ABC Corporation* did not qualify with the Secretary of State. *ABC Corporation* filed its 2000 return on March 15, 2001, reporting \$1,000 of income.

ABC will be subject to the minimum franchise tax on its 2000 taxable year return (first taxable year). The return *ABC* files for the year 2001 is the corporation's return for its second taxable year and is subject to the minimum franchise tax.

Non-qualified foreign corporations that begin doing business and then qualify in California

Non-qualified foreign corporations that began doing business in California on or after January 1, 2000, and later qualify with the Secretary of State after filing their first return, may request the

reduction within the four year statute of limitations for refunds.

Example 2

Use the same facts as Example 1, except that *ABC Corporation* qualified with the Secretary of State on March 25, 2002. On March 26, 2002, the corporation filed a claim for refund of \$711.60 for its 2000 return. The refund amount is the difference between the \$800 minimum franchise tax and the measured tax of \$88.40 (\$1,000 X 8.84 percent). Since the claim was filed within the statute of limitations, we would refund the \$711.60 plus interest.

Example 3

DCE Incorporated, a foreign corporation (calendar year corporation), began business in California on April 22, 2002. On June 25, 2002, *DCE* qualified with the Secretary of State. The corporation will file one return for the 2002 taxable year. The corporation would pay measured tax and would not be subject to the minimum franchise tax.

October 15, 2002 – Last day to e-file

You can still e-file California tax returns during the six-month extension period following the April 15, 2002, deadline.

We will accept both refund and balance due returns through October 15, 2002. (Note: The extended due date for the Internal Revenue Service is August 15, 2002.) Please remember that any taxes owed must have been

paid by April 15, 2002, to avoid any penalties and interest.

Take advantage of the many benefits of e-file. If you are not yet an approved Electronic Return Originator (ERO) and you want to e-file your clients' tax returns during the extension period, complete the fillable, *California Application to Participate in the e-file Program*,

form FTB 8633, online at <http://www.ftb.ca.gov/elecserve/>, under the section for e-file professionals.

Once you have completed the application, print, sign, and send it to us. You may fax the completed application to our e-file Help Desk at (916) 845-0287, or mail it to the address shown on the application.

Ask the Advocate

California Tax Policy Conference begins Nov 13

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This year's conference will feature discussions on:

Litigation

Representatives from the public and private sector will conduct an interactive discussion of significant pending litigation cases. The principal focus of the discussion will be California cases, but may also include cases of other states.

Legislation

A panel will provide a brief summary of the most significant pieces of California tax legislation from the 2002 legislative session. The panel members, representing divergent viewpoints, will spend the majority of the time discussing various tax issues confronting the Legislature.

California State Board of Equalization

This panel will discuss what the Board of Equalization has done in the past year. Topics will include such things as board reaction to the September 11, 2001, terrorist attacks, the situation involving assessment of power plants, and Assembly Bill 426 (Agriculture and the State Budget). One member of the panel

will be from out-of-state so a non-Californian can provide views as to sales tax from a different perspective.

Humor in the high court

The comedy team of Pomp and Frankel takes you on a rapid and hilarious ride through the recent taxation developments in the high courts throughout the nation.

The budget in the current economy High-level public and private executives discuss the state's budget and vital issues related to it in the present economy.

Underground economy

A panel will discuss what taxpayers and non-taxpayers do to take part in the underground economy and what tax authorities and prosecutors do to deal with them. The panel will provide several case examples.

Federal deregulation

In the past, federal law prohibited corporations in the banking, securities, and insurance industries from entering into each other's business domain. In 1999, federal legislation (The Gramm-Leach-Bliley Act) permitted corporations in those industries to operate within a

commonly controlled group of corporations. If these corporations become members of a single unitary group, a number of difficult issues regarding apportionment will emerge. This panel will summarize the federal changes and discuss the potential impact of those changes on state income taxation of those industries.

Tangible personal property

A discussion of the factual and legal issues relating to the concept of tangible property and how those considerations should affect whether specific items are included or excluded from the sales and property factors.

Pass through entities

This workshop will focus on the California method and taxation of pass-through entities, with emphasis on limited liability companies. It will cover common questions received by the FTB, ranging from selection of entity form through dissolution.

Bankruptcy

A panel will discuss current developments and trends in the relationships between taxing agencies and bankruptcy courts.

New laws lead to tax form changes

The President recently signed the federal Job Creation and Worker Assistance Act of 2002 (Public Law 107-147) into law. Among other things, this act allows taxpayers to take an additional first-year depreciation deduction and AMT depreciation adjustment for property placed in service after September 10, 2001, effective for the 2001 tax year. California does not conform to this act.

This act became effective after the 2001 state forms were published. We have modified the Internet versions of our affected state forms to reflect Internal Revenue Service form changes.

Should you have any questions about these clarifications, contact our Tax Forms Development and Distribution Section at (916) 845-3442.

Form change

Form FTB 3885A, Depreciation and Amortization Adjustments, 2001 Personal Income Tax Booklet;

- Pages 38 and 40, line 7, under Part III, should read:
Total federal depreciation from this activity: Enter depreciation from your federal Form 4562, line 22.
- Line 13 under Part IV, should read:
Total federal amortization from this activity: Enter amortization from your federal Form 4562, line 44.

The changes appear in the above-mentioned income tax booklet, on the flat tax form version, in the 2001 Package X, and in the first and second release of the Package X on CD ROM. The Internet version is correct.

Form change

- Form FTB 3885A, Depreciation and Amortization Adjustments, 2001 Nonresident or Part-Year Booklet;
Pages 42 and 44, Line 7, under Part III, should read:
Total federal depreciation from this activity: Enter depreciation from your federal Form 4562, line 22.
- On line 13, under Part IV, it should read:
Total federal amortization from this activity: Enter amortization from your federal Form 4562, line 44.

The changes appear in the above-mentioned income tax booklet, on the flat tax form version, in the 2001 Package X, and in the first and second release of the Package X on CD ROM. The Internet version is correct.

Form change

Form FTB 3885A, Depreciation and Amortization Adjustments, Side 2 of the Flat Version;

- Line 7, under Part III, should read:
Total federal depreciation from this activity. Enter depreciation from your federal Form 4562, line 22.
- Line 13, under Part IV, should read:
Total federal amortization from this activity: Enter amortization from your federal Form 4562, line 44.

The changes appear in the above-mentioned income tax booklet, on the stand-alone form version, in the 2001 Package X, and in the first and second release of the Package X on

CD ROM. The Internet version is correct.

Form change

Form FTB 3885, Corporation Depreciation and Amortization, shown on page 37 of the 2001 Corporation Tax Booklet, and on page 1 of the stand-alone form;

- Line 4, under Part I, Depreciation, should read:
Total depreciation claimed for federal purposes from federal Form 4562, line 22.
- Line 3, under Part II, Amortization, should read:
Total amortization claimed for federal purposes from federal Form 4562, line 44.

The changes appear in the above-mentioned income tax booklet, on the stand-alone form version, in the 2001 Package X, and in the first and second release of the Package X on CD ROM. The Internet version is correct.

Form change

Schedule B (100S), S Corporation Depreciation and Amortization, shown of Page 25 of the 2001 S Corporation Tax Booklet, and on Side 1 of the stand-alone schedule;

- Line 1, under Part I, Depreciation, should read:
Enter federal depreciation from federal Form 4562, line 22.
- Line 1, under Part II, Amortization, should read:
Enter federal amortization from federal Form 4562, line 44.

The changes appear in the above-mentioned income tax booklet, in the stand-alone form version, in the 2001 Package X, and in the first and second

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New laws lead to tax form changes

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release of the Package X on CD ROM. The Internet version is correct.

Assembly Bill 1115

For taxable years beginning on or after January 1, 2002, AB 1115 changes the method that nonresident and part-year residents use to determine their California taxes.

Form change

FTB Publication 1005, Pension and Annuity Guidelines;

- Page 1, under the What's New section, we added the following paragraph:
Note: AB 1115 which was enacted for taxable years beginning on or after 1/1/02 may change the way you calculate your California basis. Detailed instructions will be provided in the 2002 tax forms. Please continue to monitor our website for further information.
- Page 12, Basis Worksheets, we added the following note to the table located under Worksheet II - Summary of California Basis, last

column, Remaining California Basis:

Note: This column may not be reflective of the carryover amount to taxable year 2002. You may need to recalculate your California carryover basis. Detailed instructions will be provided in the 2002 forms.

The changes appear in the above-mentioned FTB Publication, 2001 Package X, and in the first and second release of Package X on CD ROM. The Internet version is correct.

View client account information anytime with *My Account Balance*

You can now view your personal income tax clients' current year payment activity, account balance, and estimated payments at anytime with *My Account Balance*.

My Account Balance, our new web application, is easy to find on our website at www.ftb.ca.gov. Look for the red circle with *IQ* inside.

The service is available 24 hours a day, seven days a week and operates in a

secure and confidential electronic environment.

To use this service you'll need your clients' social security number and customer service number.

The service provides information on up to 25 estimated tax payments made on an account. You can also view the total balance due on the account as of the date you access the service.

FTB cancels software workshop

We regret to announce that we are canceling this year's *Tax Software Workshop and Exhibit*.

We based this decision on our funding shortages and decreasing attendance at the workshops.

We are still very much committed to increasing awareness among practitioners and taxpayers about the benefits and ease of e-filing, and will continue to focus on that task.

Please watch our Website at www.ftb.ca.gov for the latest e-file program information.

Tax practitioners push California pass three million mark for e-file returns in 2002

We received 2.7 million e-filed returns in 2001. Already this year, we've received 3.3 million e-filed returns, exceeding our original projection of 3.1 million.

Tax professionals accounted for 70 percent of the total e-filed returns.

Next year we estimate we will receive 3.9 million e-filed returns, an increase of 18 percent.

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Tax News Online (www.ftb.ca.gov/education/taxnews/Index.html) is our official webpage for tax professionals. Keep your browser pointed to *Tax News Online* for news and information about the Franchise Tax Board and events affecting state income taxes. Some of

the webpage features include the *Tax News Archive* (www.ftb.ca.gov/education/taxnews/tn_arc.html) and the *Tax Practitioner Services Directory*.

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